



Office of the Washington State Auditor
Pat McCarthy

Accountability Audit Report

Department of Natural Resources

For the period July 1, 2016 through June 30, 2018

Published July 25, 2019

Report No. 1024321





**Office of the Washington State Auditor
Pat McCarthy**

July 25, 2019

Hilary Franz
Commissioner of Public Lands
Department of Natural Resources
Olympia, Washington

Report on Accountability

Thank you for the opportunity to work with you to promote accountability, integrity and openness in government. The State Auditor's Office takes seriously our role of providing state and local governments with assurance and accountability as the independent auditor of public accounts. In this way, we strive to help government work better, cost less, deliver higher value and earn greater public trust.

Independent audits provide essential accountability and transparency for Department operations. This information is valuable to management, the governing body and public stakeholders when assessing the government's stewardship of public resources.

The attached comprises our independent audit report on the Department's compliance with applicable requirements and safeguarding of public resources for the areas we examined. We appreciate the opportunity to work with your staff and we value your cooperation during the audit.

Sincerely,

Pat McCarthy
State Auditor
Olympia, WA

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AUDIT RESULTS

This report describes the overall results and conclusions for the areas we examined. In most of the areas we examined, Department operations complied with applicable state laws, regulations, and its own policies, and provided adequate controls over safeguarding of public resources. We did identify areas in which the Department could make improvements. These recommendations are included with our report as a finding.

We also noted certain matters that we communicated to Department management in a letter dated July 15, 2019, related to inventory control at the Fire Cache. We appreciate the Department's commitment to resolving those matters.

About the audit

This report contains the results of our independent accountability audit of the Department of Natural Resources from July 1, 2016 through June 30, 2018.

Management is responsible for ensuring compliance and adequate safeguarding of public resources from fraud, loss or abuse. This includes the design, implementation and maintenance of internal controls relevant to these objectives.

This audit was conducted under the authority of RCW 43.09.310, which requires the Office of the State Auditor to examine the financial affairs of all state agencies. Our audit involved performing procedures to obtain evidence about the Department's use of public resources, compliance with state laws and regulations and its own policies and procedures, and internal controls over such matters. In keeping with general auditing practices, we do not examine every transaction, activity or area. Instead, based on our risk assessment for the years ended June 30, 2017 and 2018, the areas examined were those representing the highest risk of fraud, loss, abuse, or noncompliance. The following areas were examined during this audit period:

- Finding follow-up: Agricultural revenue collection of vineyard leases
- Fire Cache – Examined operations and controls at the Fire Cache to ensure proper stewardship over supplies and equipment
- Contract monitoring: Livingston Quarry – Examined Process and internal controls at Product Sales and Leasing Division to ensure Department had adequate internal controls in place to properly monitor its contractor at the Livingston Quarry
- Surface Mining Act: Examined active surface mines to determine if the Department is adequately enforcing the surface mining act
- Commercial land leases – Examined commercial leases to ensure the Department was collecting all revenue

SCHEDULE OF AUDIT FINDINGS AND RESPONSES

2018-001 The Department did not adequately monitor its contract with Clark County related to operations at the Livingston Quarry.

Background

The Department of Natural Resources (Department) manages natural resources located on state trust lands to generate non-tax revenue for public schools, state institutions and county services. One of these resources is the Livingston Quarry.

Livingston Quarry is a state-owned rock pit located in Clark County. Adjacent to Livingston Quarry is another rock pit called Livingston Mountain Quarry, which is privately owned by Tapani Inc. and operated by Tapani's subsidiary company, Tower Rock Products.

On October 31, 2007, the Department entered into a contract authorizing Clark County (County) to remove about 50,000 tons of rock a year from Livingston Quarry for public works use. The amount of rock crushed and removed is weighed using state-certified scales and recorded on sequentially numbered scale tickets. The contract states that scale tickets must be kept and provided to the Department upon request. The contract also requires the County to submit monthly reports that document the amount of rock removed and pay a \$1.25 royalty to the Department for each ton of rock removed.

On May 31, 2011, the County entered into a professional service agreement with Tower Rock Products to operate Livingston Quarry on its behalf. The agreement required Tower Rock to account for the rock extracted from Livingston Quarry and Livingston Mountain Quarry separately.

Further, the agreement bound Tower Rock to the requirements outlined in the County's contract with the Department. The agreement required all sub-leases to be approved by the Department and the County. Tower Rock subsequently subcontracted extraction operations at Livingston Quarry to J.L. Storedahl and Sons.

From July 1, 2016, to January 16, 2019, the Department collected \$723,980 in royalty payments from the County.

Description of Condition

The Department did not have adequate internal controls to ensure the County complied with the terms and provisions of the contract.

The Department did not perform site visits with enough regularity to monitor operations at Livingston Quarry effectively. We confirmed the Department received monthly production summaries and royalty payments from the County, but did not perform procedures to verify the accuracy of the information.

Cause of Condition

The Department did not have a dedicated contract manager in place to ensure the contract terms and conditions were met. Additionally, the Department said it did not have staff to adequately oversee operations at the quarry.

Effect of Condition

Because of the lack of monitoring:

- The contractor removed rock outside the boundaries of Livingston Quarry's surface mining permit.
- The contractor stockpiled privately owned rock product on land owned by the state.
- The contractor stored foreign material on state land.
- The contractor commingled privately owned rock product with rock product from Livingston Quarry.

Without an adequate system of internal controls in place to verify the accuracy of the contractor's extraction information, the Department cannot ensure it receives all revenue to which it is entitled.

The Department stopped all operations at Livingston Quarry in January 2018 and began working with Clark County and the operator to install a system of internal controls to ensure full compliance before operations resume.

Recommendations

We recommend the Department continue working with the County and operators to implement adequate internal controls. We specifically recommend these activities include:

- Performing site visits to prevent unauthorized activities and regularly reconciling load tickets to extraction reports and productions summaries from Clark County
- Performing contract monitoring to ensure the County operates in compliance with contract terms and provisions

Department's Response

The Department does not dispute the audit findings with regards to Conditions and Recommendations.

The current Assistant Division Manager and the state lands geologist overseeing the Mining, Rock, Sand and Gravel Program became aware of issues with the Livingston Quarry and the lack of adequate controls in early 2017 shortly after they were hired into their positions. They determined that the Department was not routinely comparing load tickets to invoices from Clark County and had not been performing site visits with enough regularity to ensure unauthorized activities were not taking place. Since that time DNR has taken numerous steps to ensure these lands are being managed appropriately and in the best interest of the trust beneficiaries. A stop work order has been issued to the County and the Department has been working with the County and the operator to ensure measures are in place to address the deficiency and other contract violations before operations resume.

The Department has increased funding to the Mining, Rock, Sand and Gravel Program by ½ FTE establishing a full time Program Manager. Region staff have been identified to assist in contract administration once operations resume. A revised Plan of Operations is being negotiated between the parties and includes the following relevant provisions:

- Separation in time of mining, processing and stockpiling of remaining State rock from rock from adjacent quarry.*
- Authorization for stockpiling of the private rock on State land with compensation to State of \$350 per month for unpaid usage from November 2018 through the lifting of the Stop Work Order and \$417 per month with an annual increase of 3% from the lifting of the Stop Work Order going forward.*
- DNR has received \$50,000 2019 minimum annual payment, \$12,168 for three years' worth of stockpiling rent through October 2018, and \$13,743 for rock removed outside of the surface mining permit boundary.*
- No material will be imported to the site other than material from the adjacent quarry.*

Auditor's Concluding Remarks

We appreciate the Department's commitment to improving its internal controls. We will follow-up on the Department's corrective action in our next audit.

Applicable Laws and Regulations

The Office of Financial Management's State Administrative and Accounting Manual (SAAM), states in part:

20.15.20 Roles and responsibilities

Agency management is responsible for the agency's operations, compliance and financial reporting objectives. Therefore, the adequacy of internal control to provide reasonable assurance of achieving these objectives is also the responsibility of management. That said, every state employee has a role in effecting internal control. Roles vary in responsibility and level of involvement, as discussed below.

Given agency structure and size, individuals may assume multiple roles. However, care should be taken to address the increased risk that may result from the concentration of responsibilities.

20.15.40.c Control Activities

Control activities are policies, procedures, techniques, and mechanisms that help ensure that risks to the achievement of an agency's objectives are mitigated. Control activities are performed at all levels of the agency, at various stages within business processes, and over the technology environment.

There are three principles relating to control activities.

10. Management designs control activities to achieve its objectives and respond to risks.
11. Management designs its information systems and related control activities to achieve its objectives and respond to risks.
12. The agency implements control activities through policies and procedures.

20.15.20.d

Agency management at all levels is responsible for internal control under their span of control. Management is responsible to communicate to agency employees their explicit or implicit control activity duties. In addition, agency management should

provide channels outside normal reporting lines so agency employees can report noncompliance, problems in operations, and illegal acts.

Management is also responsible to convey the importance of internal control to all employees both by what they say and what they do. If management is willing to override controls, then the message that internal control is not important will be conveyed to employees.

Agreement No. 32-079404, states in part:

6.01 Permits and Conformance With Laws.

1. Purchaser shall obtain all permits, including licenses, permissions, consents, and approvals to be obtained from governmental agencies or third parties in connection with this Agreement, including construction of any improvements, changes, alterations, additions, repairs, or maintenance to the Property or for the conduct of any business upon the Property at the sole cost and expense of Purchaser. Copies of such permits, licenses, permissions, consents, and approvals shall be supplied to State upon demand.
2. Purchaser shall conform to all applicable laws, regulations, permits, orders or requirements of any public authority affecting the Property and the use thereof and shall correct at the Purchaser's own cost and expense any failure of compliance created through the Purchaser's fault or by reason of the Purchaser's use. In no event shall Purchaser undertake or suffer any activity to be conducted upon the Property which constitutes a nuisance which is a threat to the health or welfare of the general public.
3. Purchaser shall cause all work on the Property and all business conducted thereon during the Term to be performed in accordance with all applicable laws and all directions and regulations of all governmental agencies and the representatives of such agencies having jurisdiction. The State shall have access to the Property at all reasonable times to determine and secure

6.07 Stockpiling.

Purchaser may not stockpile Materials on the Property without written consent of State. Purchaser must designate any stockpile location in its Plan of Operations.

6.06 Fill Material.

No material from outside of the Property may be brought onto the Property for fill material or to reclaim any part of the materials removal site without the written permission from State, which State is under no obligation to approve. As part of its consideration in allowing offsite material to be placed on the Property, State may charge a fee for each unit of such material placed on the Property.

10.01 Assignment/Subcontract.

Purchaser shall not hypothecate, mortgage, assign, subcontract, encumber, transfer, or otherwise alienate this Agreement or any interest therein or engage in any other transaction which has the effect of delegating responsibilities or transferring or affecting the right of enjoyment of the Property without the prior written approval of the State which shall be at the sole discretion of State. In granting such approval, State reserves the right to change the terms and conditions of this Agreement.

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

Department of Natural Resources July 1, 2017 through June 30, 2018

This schedule presents the status of findings reported in prior audit periods.

Audit Period: July 1, 2014 – June 30, 2015	Report Ref. No. 1017809	Finding Ref. No.: 2015-001
Finding Caption: The Department of Natural Resources did not establish adequate internal controls over its orchard and vineyard leases.		
Background: We found the Department did not adequately monitor to ensure lessees complied with the lease terms. Specifically: <ul style="list-style-type: none">• The Department accepted crop reports from 11 lessees (35 percent) that contained crops that were not authorized.• Monitoring visits for 28 leases (90 percent) were not performed by agricultural staff during the year to determine reasonable and expected crop production, and subsequent revenue collection.• The Department did not complete a preliminary crop report for 28 leases (90 percent), as required by its own policy in order to estimate the expected crop revenues.• For 10 leases (32 percent), the Department did not review expenses claimed by the lessees for allowability. Additionally, adequate supporting documentation such as receipts or invoices were not obtained to verify the accuracy of the expenses. By not establishing adequate internal controls, the Department is at a higher risk of not receiving all revenues it is entitled to. There is also an increased risk that lessees are not compliant with the terms and conditions of lease agreements. As a result of the conditions listed above, we calculated the Department may not have collected an additional \$259,236 in revenues from lessees.		
Status of Corrective Action: (check one) <input type="checkbox"/> Fully Corrected <input type="checkbox"/> Partially Corrected <input checked="" type="checkbox"/> Not Corrected <input type="checkbox"/> Finding is considered no longer valid		
Corrective Action Taken: <i>We did not review the finding during the SFY18 accountability audit because the Department had not fully implemented its corrective action plan. The cause was primarily due to the high turnover of staff in positions directly related to creating and implementing new guidance and processes.</i>		

The turnover in these important positions had the unintended consequence of muting the urgency and necessity of producing a solution and response as information related to the audit was not communicated to incoming staff.

This lack of transfer of knowledge from departing staff in addressing the audit findings has resulted in technical program staff not being able to decipher audit notes left by the original state auditor who performed the region inspections.

RELATED REPORTS

Financial

We perform an annual audit of the statewide basic financial statements, as required by state law (RCW 43.09.310). Our opinion on these financial statements is included in the Comprehensive Annual Financial Report (CAFR) prepared by and available from the Office of Financial Management.

The CAFR reflects the financial activities of all funds, organizations, institutions, agencies, departments and offices that are part of the state's reporting entity. That report is issued by the Office of Financial Management in December of each year and can be found at www.ofm.wa.gov.

A summary of the audit for the period ending June 30, 2018, can be found at: <https://www.sao.wa.gov/about-audits/about-state-government-audits/>

Federal programs

In accordance with the Single Audit Act, we annually audit major federal programs administered by the state of Washington. Rather than perform a single audit of each agency, we audit the state as a whole. The results of that audit are published in a report issued by the Office of Financial Management in March of each year.

Special investigations

The State Auditor's Office issued a report pursuant to the State Employee Whistleblower Act (Chapter 42.40 RCW). That report is available on our website, <http://portal.sao.wa.gov/ReportSearch>.

INFORMATION ABOUT THE DEPARTMENT

Created in 1957, the role of the Washington State Department of Natural Resources is to protect and manage more than 5.6 million acres of forest, range, agricultural, aquatic, and commercial lands for Washington citizens. Nearly three million acres are state trust lands, most of which were given to Washington at statehood by the federal government. State trust lands managed by the Department to help support counties, public schools, universities and colleges, capitol buildings, prisons and state institutions, local services in many counties, and the state General Fund. Department-managed lands also provide many other public benefits, such as destinations for outdoor recreation, fish and wildlife habitat, and clean air and water. The Department also protects natural resources through fire prevention and suppression and regulating forest practices.

For the audit period, the Department employed approximately 1,252 permanent employees. Elected Commissioner of Public Lands, Hilary Franz, heads the Department. For the 2018-2019 biennium, the Department had operating budgets of approximately \$418 million.

Contact information related to this report	
Address:	Department of Natural Resources P.O. Box 47041 Olympia, WA 98504-7041
Contact:	Charles Malone, Risk Manager
Telephone:	360-902-1264
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Information current as of report publish date.

Audit history

You can find current and past audit reports for the Department of Natural Resources at <http://portal.sao.wa.gov/ReportSearch>.

ABOUT THE STATE AUDITOR'S OFFICE

The State Auditor's Office is established in the state's Constitution and is part of the executive branch of state government. The State Auditor is elected by the citizens of Washington and serves four-year terms.

We work with our audit clients and citizens to achieve our vision of government that works for citizens, by helping governments work better, cost less, deliver higher value, and earn greater public trust.

In fulfilling our mission to hold state and local governments accountable for the use of public resources, we also hold ourselves accountable by continually improving our audit quality and operational efficiency and developing highly engaged and committed employees.

As an elected agency, the State Auditor's Office has the independence necessary to objectively perform audits and investigations. Our audits are designed to comply with professional standards as well as to satisfy the requirements of federal, state, and local laws.

Our audits look at financial information and compliance with state, federal and local laws on the part of all local governments, including schools, and all state agencies, including institutions of higher education. In addition, we conduct performance audits of state agencies and local governments as well as [fraud](#), state [whistleblower](#) and [citizen hotline](#) investigations.

The results of our work are widely distributed through a variety of reports, which are available on our [website](#) and through our free, electronic [subscription](#) service.

We take our role as partners in accountability seriously, and provide training and technical assistance to governments, and have an extensive quality assurance program.

Contact information for the State Auditor's Office	
Public Records requests	PublicRecords@sao.wa.gov
Main telephone	(360) 902-0370
Toll-free Citizen Hotline	(866) 902-3900
Website	www.sao.wa.gov